Thoughts from

Hanson Investment Management Inc.

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So What's on Your Reading List?...

IF YOU EVER WONDERED WHAT'S ON OURS and what we use to put this newsletter together, well here you go – our best of the best from the business press.

"Stuck on a Desert Island with just One Publication" – This is easy. The best single financial read in the world is the *Economist*. Period.

"Best Writers on Economics" – Robert Samuelson in *Newsweek* is right up there. Also Paul Krugman in the *New York Times*. He is a bit tough for conservatives to take but he is smart as a whip and always logical. The best Wall Street Global Economist for my money is Stephen Roach at Morgan Stanley.

"Best Writers in Personal Finance" – I always turned up my nose at *Money Magazine*. Along with *USA Today*, it is the "Hawaiian Shirt of Journalism." But you know, it has good stuff. Especially watch for Jason Zweig on behavioral finance. Also I never miss articles by Burton Malkiel, John Bogle and Jeremy Siegel wherever they appear. They are at the top of the game.

"Best Publication You May not Have Heard Of" – If you want to keep up on globalization you can't go wrong with *Foreign Policy*. The other publication *Foreign Affairs* is better known but it can be awfully dry and academic. Moises Naim always keeps things readable and interesting in *Foreign Policy*.

"Best Of The Traditional Business Mags" – For my money it is *Business Week*. An excellent blend of economics and business trends. *Forbes* is good on new companies, *Smart Money* has great columnists and I look for James Surowiecki's economics column in the *New Yorker*.

"Best Newspaper" – We try to get through six papers a day. For U.S. business you have to go with the gold standard, the *Wall Street Journal*. Simply excellent reporting. And for a global read it's the *International Herald Tribune* possibly the best single paper in the world. Previously it was owned by the *Washington Post* and the *New York Times* so you got the best of both. Alas the *Times* has taken sole possession so you miss the *Post* writers but it is still a great read.

There you have it, our best of the best. Now for the big problem, trying to find the time for all that reading. Good luck!

–*E.H.*

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Hanson Investment Management is an investment counsel firm managing portfolios for individuals and institutional clients. The firm also consults with individuals on financial planning and works with self-directed retirement plans on investment options.

Global Awareness . . .
Parlez Vous . . . English? . . .

WE ARE A PRETTY PROVINCIAL bunch here in the U.S. We don't do well with foreign languages. In fairness there are some long-term reasons for this. One is history. We have always had a bit of an isolationist streak in us. Prior to World War I and also World War II we were reluctant participants on the world stage. When Germany rose economically and militarily in World War I our reaction was not to learn more about them but to ban the teaching of German in public schools!

"For all the anxiety that science and math education inspires, the state of global languages, politics, history and culture in U.S. schools may actually be scarier."

–*Foreign Policy*, May/June 2006

Geography has also worked against us. We are large and isolated from others by two big oceans. We often feel ourselves apart. And finally there is prosperity. When you have as big a market as ours, the U.S. economy is 2½ times the next largest developed country, you don't need to focus abroad. When you haven't even developed customers in Arizona you aren't going to get that excited about Thailand, Brazil or even Germany.

Well this all is changing quickly. With the fall of the Berlin Wall and the Soviet Union the world has gotten a lot more integrated a lot more quickly. The term globalization was an interesting new term when Thomas Friedman published *The Lexus and the Olive Tree* in 1995. Now as Roger Altman says in his new column "Managing Globalization" in the *New York Times*, it is the "Unavoidable Thing." The world is a lot more important to us today.

But we still have a long way to go in mastering anything but English. In commerce you technically don't need more than English. Many European companies have gone to English as the default language for meetings. But learning a language is bigger than just getting through a meeting. It is a window to a new culture. Knowing the language means you know a lot more about the people and how they work. And what is it they say – all business is people. When John F. Kennedy used the German, "Ich bin ein Berliner" he won over a whole country. Speaking someone's language is the ultimate courtesy. It is the opposite of our present day "shock and awe." It is "warmth and trust."

It's going to take work however to turn the ship. In China today 200 million students study English. In the U.S. just 24,000 Americans study Chinese. It is estimated that 92% of American college undergraduates never take a foreign language class. The President has addressed this in the most recent budget but it is more talk than action. He is asking for $24 million to promote foreign language instruction in K-12 schools. This compares to $206 million requested to fund abstinence-only sex education. But a start is a start. The U.S. has shockingly few fluent speakers in Arabic and Farsi and not many more is Chinese, Hindi and Russian.

What can be done? My advice is to just DO IT. There are all sorts of language training programs and you can dovetail this with foreign travel and foreign affairs/ history/ geography courses at colleges and other places. I have been struggling studying Mandarin Chinese now for fifteen years. There are many reasons I do this but the biggest is that the next century I feel is going to be about China and the U.S. Knowing more about them will get me better prepared for the great economic threats as well as the new investment opportunities that lie there.

For those in school now the motivation for learning a foreign language should be pure selfishness. It's all about the jobs, stupid. Companies want and need employees who better understand the world. UPS for instance operates in more than 200 countries. They have established a "global trade curricula" for their 400,000 plus employees and they seek new hires who speak multiple languages. "We are going to be partnering with foreigners. We need to understand their culture and their language," the CEO says.

Almost half of all college bound U.S. students say they want to study abroad. Only 1% actually do. And of those, about 50% go to the traditional four European countries: Britain, France, Italy

"Only six years ago the College Board offered two Advanced Placement (AP) exams on the writings of the Roman poet Virgil, and none on the politics, economics, history and literature of five of the world's continents"

–*Foreign Policy*, May/June 2006

In 2007 the College Board will be offering AP Chinese. –*ed.*

and Spain. You can learn a lot there but they are not exactly on the cutting edge of the new countries of globalization.

What languages should you study? I'll leave that to you but for me the two top ones for business are Spanish and Chinese. Spanish will cover you in the southern half of the U.S. (and this is moving north quickly), most all of South America, Spain and the Philippines. Chinese is not going to be that valuable for you outside of China but that may be enough what with the mainland's growing economic clout. Every major multinational company has a "China strategy," either trying to sell to them, buy from them or manufacture there – or all three. You will be pretty valuable in most U.S. companies with Chinese proficiency. –*E.H.*

Investment Themes:

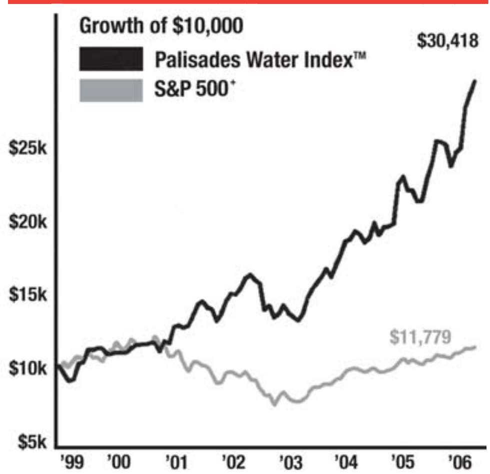
"Water Water Everywhere, Nor Any Drop to Drink"

–Samuel Taylor Coleridge, "The Rime of the Ancient Mariner"

IS SCARCE CLEAN WATER THE next big investment theme? Here are signs that it might be: In the last five years, the Palisades Water Index, composed of water-related technology, service, and utility companies, has outperformed the S&P 500 by nearly 5 times *(see chart to the right)*. Texas billionaire Boone Pickens has spent more than $50 million for water rights around his ranch in north Texas with the thought of building a $2 billion water pipeline system. General Electric CEO Jeffrey Immelt is saying that demand for clean water could double the revenue his company gets from water treatment to $5 billion in 2010.

While there is plenty of water in the world, 97% of it is saltwater, and most of the remaining fresh water is locked in polar icecaps or glaciers. A combination of factors is increasing the pressure on supply – climate change, population growth, worldwide urbanization, higher demands for food security, and pollution. The crux of the problem is that water is unevenly distributed and difficult to transport. The United Nations water report released earlier this year shows that only about 15% of the world's population enjoys relative abundance in natural water supply. About 65% faces low to moderate supply, and 20% has no appreciable access. The UN also tells us that by 2050, 2 billion people in 48 countries will face water shortages.

Index Performance*



Source: www.powershares.com

All of this makes water investment seem like a no-brainer, but there are a few challenges. One is that there are very few pure water plays out there. The 30 water-related stocks in the Palisades Water Index (ZWI) include diversified industrial giants like GE and Siemens, as well as companies like Pall Corp., a maker of filtration and separation products for everything from blood collection to oil refining to semiconductor manufacturing, as well as water. And major water utilities often are involved in power supply, communications, or transport too. This is true of the world's two largest water utilities, Suez SA and Veolia Environnement, which was spun off from Vivendi.

Another issue is that we have trouble treating water like an economic good with a price. This creates difficulties for utilities and may be one reason privatization has not taken place as rapidly as once expected. Only 5% of water services worldwide are private. RWE, Germany's largest electric company, entered the U.S. water business several years ago but is looking to exit after facing regulatory issues and public protests. Suez has reduced exposure to developing countries. Veolia continues to expand abroad but has sold many of its U.S. businesses.

You may think the solution is to forget about the gold and go for the makers of the gold pans. There are plenty of interesting companies in equipment, processing, and services – the table below shows a sampling of the breadth of the water industry. The problem here is that this is an expensive group of stocks.

So what is an investor to do? An easy way to get exposure to water is to go with a diversified blue chip like GE, which has invested more than $3 billion into its water business and expects to generate more than half of its revenues from emerging markets. One might also look at the water ETF (Ticker PHO), albeit at a lower price. We are sitting tight and watching. For us, water is a major global investment theme, but only at the right price. *–J.W.*

Some Water Players

Company	Ticker	Products/services	Price	P/E	P/CF*	Market Cap	Dividend Yield
Cia de Saneamento Basico (ADR)	SBS	Water utility, Sao Paolo, Brazil	23.91	5.8	3.3	2.7B	none
Veolia Environnement (ADR)	VE	Global water utility; transportation	51.89	25.4	4.8	21.1B	2.1%
United Utilties (ADR)	UU	Multi-utility, northwest England	23.93	17.3	7.8	10.5B	9.1%
General Electric	GE	Diversified	33.30	18.6	9.4	346B	3.0%
URS Corp	URS	Pollution control/hazardous waste	40.58	18.8	9.5	2.1B	none
California Water Services	CWT	Water utility, CA, NM, WA	35.15	25.9	12.4	647M	3.3%
Nalco Holdings	NLC	Industrial water treatment	17.55	37.0	12.4	2.5B	none
Pentair	PNR	Diverse water technologies	33.51	17.9	13.6	3.4B	1.7%
Calgon Carbon Corp.	CCC	Carbon-based water/gas purifiers	5.78	NMF	18.0	272M	2.1%
Watts Water Technologies	WTS	Water regulation/ flow devices	31.75	17.8	20.3	1.0B	1.1%
Insituform Technologies	INSU	Sewer, tunnel, pipelines repair	22.62	38.9	25.7	613M	none

*Ranked by price to cashflow

Source: Bloomberg

Economic Trends . . .

A Rising Tide Does Not Lift All Boats . . .

BY MOST MEASURES, THE U.S. economy is in good shape. The unemployment rate is down to 4.7%. Productivity growth is high and the economy is growing strongly. But ironically, many Americans are not feeling quite so cheery in the face of all this good news. A recent *New York Times/CBS News* poll found that 46% of respondents felt that the economy was in fairly bad or very bad shape. And consumers' overall assessment of current economic conditions recently declined for the second month in a row.

I think one of the primary reasons behind this disconnect is summed up *in the chart below.* According to data issued by the Federal Reserve, the average net worth of an American family rose 6.3% between 2001 and 2004. But average calculations can be skewed by very high and low numbers. Looking at median (the midpoint between the top 50% and bottom 50%) results provides a better clue as to how the typical family is faring. *As the chart shows*, median net worth has barely budged over the period and for the bottom 40% of families by income, median net worth actually fell.

A recent Northwestern University study sheds further light on income trends. In studying the 1972-2001 period, professors Ian Dew-Becker and Robert Gordon found that the income of the highest 99th percent of earners increased 87%; the incomes of those in the 99.9th percentile rose 181% and those in the 99.99th percentile saw their incomes gain 497%. The conclusion? The majority of income gains in the period went to society's peak earners. Not surprisingly, the same study concluded that corporate executives accounted for more than half of the top 0.01 percent of the U.S. income distribution.

For anyone reading the business headlines, this information is not surprising. Shareholder discontent over escalating CEO pay packages was well publicized during the recently completed proxy voting season. But, unfortunately, my sense is that these protests have had little impact on the behavior of corporate compensation committees. Perhaps it is some relief to realize that the growing trend toward income inequality is not just a U.S. phenomenon. Thanks to globalization, many countries have adopted flexible labor laws. But while this development has enhanced job creation, it has also eliminated the safety nets once in place for marginal workers.

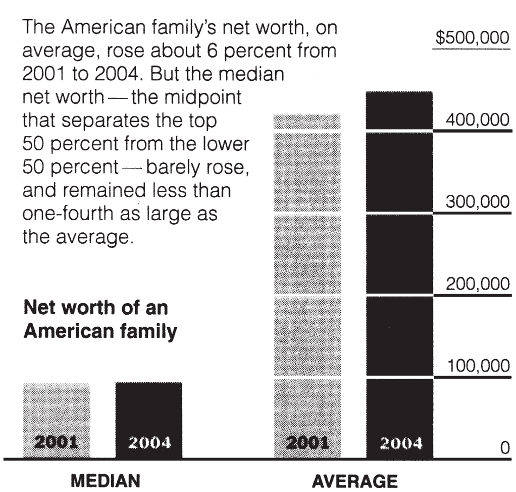
So is it really a problem that a few fat cats get super rich while everyone else plugs along? I think the answer is yes. A growing income gap strikes at the very heart of America's capitalist system. Over the last two centuries, millions of immigrants came to the U.S. believing that they too could get ahead through hard work and education. But current income trends call this assumption into question. The 2006 Economic Report of the President, for example, found that real earnings of college graduates rose less than 1% per year between 1975-2004 and actually fell 5% from 2000-2004.

The current debate on eliminating the estate tax also suggests a growing discontent with income distribution trends. Today, the estate tax affects only the richest 0.5% of Americans. But despite this limited impact, most Americans have strong opinions as to whether the tax should stay or go. Conservatives feel that the levy is unfair because it taxes the same income twice; once when earned and then at death. But others, including billionaire Warren Buffett, feel that the estate tax should remain in place. The current estate tax, Buffett argues, effectively redistributes wealth and fuels innovation.

So who is right? Eliminating the tax entirely seems imprudent given the current budget deficits. But increasing the exemption per couple to the currently proposed $10 million level would leave only America's wealthiest citizens subject to the tax. The estate tax was originally passed back in 1916 as a way to prevent excessive concentrations of wealth. Given current income trends, this might not be a bad objective today.

–*A.D.*

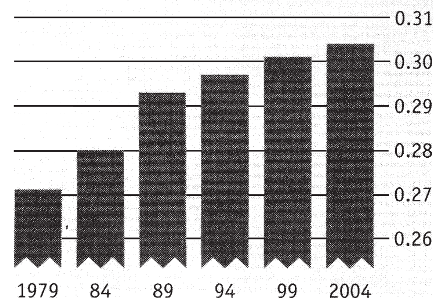
FAMILY VALUES



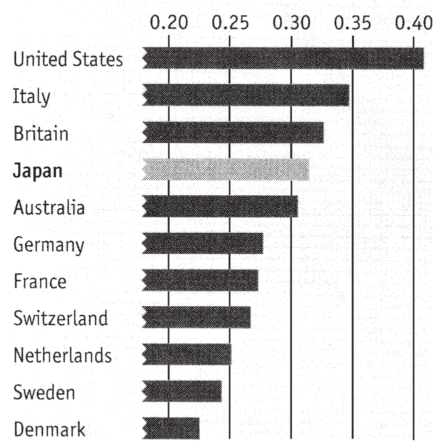
Source: New York Times

THE PERILS OF AGING

Japanese income distribution, Gini coefficient*



Income distribution, Gini coefficient*
2000 or most recent year



*0=Perfect equality of income, 1=Perfect inequality of income
Sources: National Survey of Family Income and Expenditure; OECD; World Bank

Source: The Economist